

IDAHO OUTLOOK

NEWS OF IDAHO'S ECONOMY AND BUDGET

STATE OF IDAHO

DIVISION OF FINANCIAL MANAGEMENT

JULY 2006 VOLUME XXVIV NO. 1

There are several ways to prepare an Idaho potato. The state's official vegetable can be baked, boiled, roasted, chipped, fried, dried, sliced, diced, riced, mashed, julienned, chopped, waffled, steamed, creamed, and crinkled. Similarly, there are several ways to dissect the state's economy. In this issue of the *Outlook* we focus on the components of Idaho's Gross State Product (GSP). Our analysis is based on estimates released by the U.S. Department of Commerce in early June 2006. The Department of Commerce defines GSP as "the value added in production by the labor and capital located in a state." In our analysis, we compare each major industry's value added to the Idaho's total GSP in order to provide a better understanding of the economy's structure. In order to avoid having one-time events skew the results, eight-year averages from 1997 to 2004 were used.

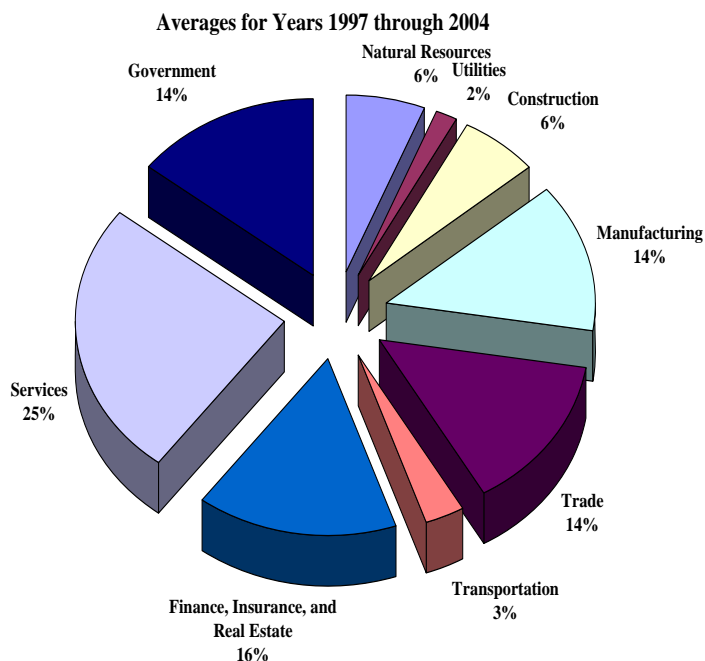
Each of Idaho's industries occupies one of three distinct groups based on its share of the state's total output. The services sector is the sole tenant of the first group. This industry alone accounts for one out of every four dollars of Gem State GSP. Its dominance reflects its components, which include two extremely high-value industries—health care and professional and technical services. Together they account for nearly 13% of the state's total GSP. Professional and technical services has been the fastest growing share of the two industries. It has grown from 6.3% of the state's GSP in 1997 to 7.0% in 2004. In comparison, health care's share has moved from 6.0% to 6.6% over the same period.

The next largest group is more crowded than the first group. It consists of government; trade; manufacturing; and finance, insurance, and real estate industries. In this group,

each industry's share accounts for 14% to 16% of total GSP, with a combined share of 58% of total Idaho output. The finance, insurance, and real estate slice is the largest at 16%. However, it needs to be pointed out that rents are included in real estate output. Thus, this share is larger than most would expect. Government, trade, and manufacturing each have 14% of total Idaho output, which is about the same as their respective national counterparts

The last group consists of four sectors that collectively account for the remaining 17% of the state's economic output. They are construction (6%), natural resources (6%), transportation (3%), and utilities (2%). The natural resources sector mainly consists of agriculture, mining, and forestry. Its relatively small share of the state's output belies this sector's importance to the local economy. A

Industry Shares of Idaho GSP



Source: U.S. Department of Commerce, Bureau of Economic Analysis

couple of statistics illustrate this point. First, Idaho's natural resource sector is a much larger portion of Idaho's economy than it is at the national level. Specifically, its 6% share of total Idaho output is three times higher than resource's 2% share at the national level. Second, the "value added" concept does not reflect the strong linkages between the resource sector and certain manufacturing industries, which tends to underestimate the resource industry's overall economic contribution. For example, the state's food processing and wood manufacturing sectors are highly dependent on the output of the resource sector. The collective share of Idaho's resources, food processing, and wood product manufacturing sectors is 11% of total output. At the national level, these sectors combined account for about 4% of output.

JAMES E. RISCH, Governor

Division of Financial Management
700 W. Jefferson, Room 122
PO Box 83720

Boise, Idaho 83720-0032 (208) 334-3900

PRSRT STD
U.S. POSTAGE
PAID
PERMIT NO. 1
BOISE, ID 83720

RETURN SERVICE REQUESTED

Brad Foltman, Administrator

Economic Analysis Bureau

Michael H. Ferguson, Chief Economist

Derek E. Santos, Economist

General Fund Update

As of June 30, 2006

		\$ Millions		
Revenue Source	FY05	FY06 Executive Estimates		FY06
	Actual	Jan. 05	Jan. 06 ¹	Actual
Individual Income Tax	1,035.5	1,044.2	1,096.7	1,216.5
Corporate Income Tax	139.6	135.1	164.4	194.1
Sales Tax	950.8	791.4	836.4	880.8
Product Taxes ²	22.8	23.4	23.3	23.5
Miscellaneous	119.0	96.0	108.4	116.4
TOTAL GENERAL FUND³	2,267.7	2,090.1	2,229.1	2,431.3

¹ Executive estimate as adjusted for 2005 legislative action

² Product Taxes include beer, wine, liquor, and cigarette taxes

³ May not total due to rounding

General Fund revenue growth set a record for modern times in FY 2006, coming in 16.2% above the previous fiscal year on a *normalized* basis. Actual revenue growth in FY 2006 was an increase of 7.2% from FY 2005, but this seemingly contradictory result was the consequence of the sales tax rate declining from 6% to 5% on July 1, 2005. Actual revenue growth in FY 2004 was 18.9%, but this result was due to the increase in the sales tax rate from 5% to 6% on April 1, 2003. The normalized growth rate for FY 2004 is a much more modest 8.8%. The last time actual General Fund revenue growth exceeded the FY 2006 normalized rate was in FY 1984, when the sales tax rate was increased from 3% to 4.5%. Overall General Fund revenue growth that year was 21.3%, but this was dominated by a 46.7% increase in gross sales tax collections. Without the sales tax rate increase, normalized General Fund revenue growth in FY 1984 would have been less than half the 21.3% actually recorded.

Idaho's spectacular FY 2006 revenue performance is similar to the experience of many states (especially those in the West) and the federal government. Most of the surge came from the individual and corporate income taxes,

but in Idaho the sales tax was also exceptionally strong. Much of the unanticipated gains appear to be directly and indirectly related to the real estate boom.

Individual income tax revenue was up 17.2% in FY 2006, the fastest growth rate since 19.5% growth in FY 1989, when two additional rate brackets were added. This growth is particularly impressive when one considers that the current estimate of Idaho personal income growth in 2005 is 7.4%. The most likely explanation behind this exceptional income tax growth (vs. income growth) is capital gains, which are a part of the income tax base but are not a part of personal income. Strong capital gains are most likely due to a combination of rapid increases in real estate values and the large gains in stock values in 2005.

Corporate income tax revenue was up 39.1% in FY 2006. Only two fiscal years managed to achieve faster growth over the past two decades, 50.2% in FY 1995 and 61.2% in FY 1985. The strong growth in FY 1995 was almost entirely due to exceptionally high memory chip prices in the early 1990s, and the FY 1985 strength was due to unusually low

corporate income tax revenue in FY 1984 resulting from court-mandated refunds.

Sales tax revenue shrank 7.6% in FY 2006, not a particularly strong performance at face value. However, the normalized growth rate for the sales tax was 13.7% in FY 2006 after controlling for a combination of rate and distribution changes. Sales tax revenue comparisons over time are complicated by a series of both rate and distribution formula changes. A simple way of dealing with this involves converting gross collections to a constant rate. On this basis only FY 1993 (with growth of 12.5%) outperformed FY 2006 growth of 12.2%. One has to go all the way back to the 1970s (with its correspondingly higher inflation) to find normalized sales tax gross collection growth in the range of 14-18%.

Product taxes came in very close to expectations for the fiscal year, while miscellaneous revenues were quite significantly above the predicted amount. Eighty-five percent of the unexpected gain in miscellaneous revenue was due to higher than expected interest earnings.